

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 98-26**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether nexus of subsidiary corporation gives rise to nexus of parent corporation.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

The Taxpayer is a [PRODUCER] of [MERCHANDISE] and other related materials. The Taxpayer is headquartered outside of Tennessee and has no office, employees, agents, inventory, or other business location in Tennessee.

The Taxpayer distributes the majority of its products through independent distributors and a wholly owned subsidiary. All sales to the distributors and the subsidiary are made for resale. The transactions with the subsidiary are treated at arms' length and the subsidiary receives the same terms as the independent distributors. The subsidiary is registered and remits sales tax in all relevant jurisdictions, including Tennessee, in which it does business, or maintains documents on exempt sales. To the best of the Taxpayer's knowledge, the independent distributors also collect and remit sales and use tax as required by law.

The Taxpayer also sells [MERCHANDISE] and related materials through the mails and common carriers for orders received at its headquarters via the phones or mail. These are the only retail sales made by the Taxpayer. Solicitation of these orders is made exclusively by direct mail.

The Taxpayer is planning to merge the subsidiary into the Taxpayer. The Taxpayer will then conduct the subsidiary's business activities. The merger will create nexus as the sales force of the subsidiary will now be employees of the Taxpayer. Therefore, the Taxpayer will be required to register for sales and use tax in all states in which it is not currently registered. All future sales will require that tax be collected and remitted unless exempt under state law. The Taxpayer has not previously collected sales and use tax in Tennessee.

The Taxpayer and subsidiary are presently legally separate entities. The sales, at wholesale, of [MERCHANDISE] to the subsidiary have always been conducted at arms' length. The pricing structure between the Taxpayer and the subsidiary has been developed using the same arms' length transaction standard that exists between the Taxpayer and independent distributors. The subsidiary's employees are not authorized to, nor do they in fact, solicit sales on behalf of the Taxpayer, or engage in any other activities on behalf of the Taxpayer.

ISSUE

Whether the Taxpayer has nexus for sales and use tax purposes in Tennessee prior to the merger because of the activities of the subsidiary.

RULING

The Taxpayer does not have nexus for sales and use tax purposes in Tennessee prior to the merger.

ANALYSIS

A tax will survive challenge under the Commerce Clause so long as it (1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 97 S.Ct. 1076 at 1079 (1977).

The first requirement is determinative in this case: whether the Taxpayer has connections with Tennessee which are substantial enough to legitimate Tennessee's exercise of power over it. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992). The determination of nexus is based on the relevant facts and circumstances. The Taxpayer is headquartered outside of Tennessee and has no office, employees, agents, inventory, or other business location in Tennessee. The Taxpayer does not own the products shipped into Tennessee to its subsidiary, but has sold the items to the subsidiary for resale. The Taxpayer's connection with Tennessee, if any, is through the actions of its subsidiary.

Based on the facts provided, the subsidiary does not solicit sales or take any action on behalf of the Taxpayer, but only purchases for resale and distributes the Taxpayer's products. Although the subsidiary does conduct business in Tennessee, it appears to have no more connection with the Taxpayer than does an independent corporation doing the same type of distribution activities. See *Pearle Health Services, Inc. v. Taylor*, 799 S.W. 2d 655 (Tenn. 1990); *The Reader's Digest Assoc., Inc. v. Mahin*, 255 N.E.2D 458 (Ill. 1970), *cert. den'd*, 399 U.S. 919, 90 S. Ct. 2237, 26 L. Ed. 2d 786 (1970). Accordingly, the activities of the subsidiary do not give rise to nexus with the Taxpayer prior to the merger of the Taxpayer with the subsidiary.

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APPROVED: _____
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